CITY OF
HAYWARD
HEART OF THE BAY

**DATE:** October 21, 2013

**TO:** Council Budget & Finance Committee Members

**FROM:** Director of Finance

**SUBJECT:** FY 2013 Preliminary Year-End General Fund Review

**RECOMMENDATION**

No action required. Staff is requesting that the Committee reviews and comments on this summary.

**BACKGROUND**

The Finance Department is currently working with the City's outside auditor to develop and finalize the financial statements for the period ending June 30, 2013 (FY 2013). The full results of the audit and the FY 2013 Comprehensive Annual Financial Report (CAFR) are currently scheduled to be presented to City Council in February 2014. This report contains preliminary year-end results for the General Fund that will likely be somewhat modified through the audit process.

The City Council adopted the FY 2013 budget on June 26, 2012, initially projecting a General Fund gap (and use of the General Fund Reserve) of $5.6 million. This projection was modified over the course of the fiscal year, with a third quarter projected gap of $3.3 million discussed with the Council Budget & Finance Committee on May 22, 2013. Early FY 2013 results indicate that the General Fund will end with a positive balance of $226,000 (refer to Table 1). The primary cause for this year-end change from previous projections is one-time revenue and deferred expenditures. If the one-time revenue outlined in the discussion below ($1.9 million) is removed, the FY 2013 year-end balance would show a deficit of approximately $1.7 million.

While this year-end result means the City does not likely have to expend its General Fund Reserve funds to balance FY 2013, the budget picture is not as optimistic as it might seem. The General Fund Ten-Year Plan projects a deficit in FY 2014 of $2.6 million – which assumes $1.1 million in additional employee concession savings that grows significantly in future years. In addition, the Ten-Year Plan does *not* include full funding for the City's benefit liabilities and critical infrastructure costs.

> *For example, inclusion of full funding of the City's Retiree Medical program Annual Required Contribution (currently being phased in through FY 2019 to ease budgetary impact) would increase costs by $3.9 million and would have resulted in an FY 2013 gap of $3.6 million instead of the surplus of $226,000. This is very significant and must be considered when discussing the overall fiscal health of the City.*

Even with some improving revenues, the City's expenditure budget – the other half of the City's fiscal picture – will continue to drive recurring annual shortfalls without additional, recurring balancing measures.

## DISCUSSION

### Preliminary Year-end FY 2013 Revenue Performance (refer to Table 1)

The initial revenue projections for FY 2013 were appropriately conservative, given the volatile economy and the rapid loss of General Fund revenues in the preceding years. Fortunately, as the fiscal year progressed, the City began seeing increased revenues from an improving local economy and staff provided quarterly budget updates with recommended adjustments to FY 2013 revenues.

Overall General Fund revenues improved over third quarter projections by $2.5 million or 2.1%. While many revenues reflect minor variances over projections (positive and negative), several revenue categories ended the year with more significant variances, some one-time in nature, as discussed below.

*Property Tax* – Preliminary year-end revenues indicate a variance of $1.98 million (5.3%) over third quarter projections. Third quarter adjustments included increased recurring revenues of $632,000 based on improved real estate market activity as seen during the third quarter review and a one-time payment of $870,000 for over-charged Property Tax Administrative Fees by Alameda County. The year-end results reflect additional savings and are driven by two factors: 1) improved secured property tax revenues and 2) allocations as part of the redevelopment dissolution – mainly one-time in nature.

1) Improved Secured Property Tax revenues. Approximately $580,000 of the variance is attributable to improvements to secured property tax revenues. Future secured property tax revenue projections will be adjusted as appropriate based on actual year-end results and will be communicated to City Council as part of the FY 2014 Mid-Year review and General Fund Ten-Year Plan Update in late February 2014.

2) Real Property Tax Trust Fund (RPTTF) – former Redevelopment Agency distribution. The majority of this year-end variance is attributed to redistributions of property tax as part of the redevelopment agency dissolution, with unbudgeted revenues of $1.4 million. The RPTTF represents reallocated property tax increment previously allocated to the former Hayward Redevelopment Agency. With the dissolution of the agency, tax increment funds are now redistributed to all taxing entities in the County. These funds were not budgeted in FY 2013 due to the uncertain nature of the dissolution process by the State of California. Below is a summary of the composition of the unanticipated $1.4 million in RPTTF revenue – with $1.1 million being one-time revenue distributions.

    - $350,000 – recurring, annual redistribution amount not budgeted in FY 2013. This is budgeted in FY 2014 and future years.
    - $483,000 – a one-time redistribution dictated by the results of the Due Diligence Review (audit) of the Low-Moderate Income Housing Fund.
    - $617,000 – a one-time adjustment to the RPTTF distribution by the State Department of Finance because it was determined that the Successor Agency had retained fund balance in excess of enforceable obligation payments required. The Department of Finance adjusted the amount of RPTTF that the Successor Agency received so that fund balance was used to pay enforceable obligations. This resulted

in additional RPTTF being distributed to all of the taxing entities in FY 2013, of which the City is one.

As the RDA dissolution process continues, the RPTTF distributions should stabilize at a fairly consistent level. This will likely occur by FY 2015, as many of the one-time dissolution adjustments will be completed by the end of FY 2014 (e.g. audits, property disposition, etc.). Effective FY 2014, staff projected approximately $350,000 annually in redistributions that would be used to fund the increased Economic Development budget consistent with the Strategic Plan as adopted by City Council. This projection still holds, although it is possible the ongoing redistribution may be slightly higher once stabilized ($400,000-450,000 annually). Staff will continue to monitor the remittances and expenses to refine this projection.

<u>In the meantime, staff recommends that the Council set aside any one-time redistribution from the RDA dissolution process (including the FY 2013 redistributions totaling $1.1 million) into a separate capital project fund that could be utilized for economic development initiatives or other capital projects, consistent with the one-time nature of these funds.</u>

For FY 2014, staff is already aware of several occurrences that will result in one-time redistributions of property tax revenues as well as a one-time transfer out of the General Fund. The completion of the Other Funds Due Diligence Review (audit) and the sale of the residual Burbank School site will generate one-time RPTTF funds of about $1.6 million that will be remitted to the General Fund. As part of the audit, DOF denied the validity of a loan the City's General Fund loan made to the Redevelopment Agency in the 1970s. The former RDA made payments towards this loan in March 2011 totaling $2.2 million, which the DOF has also denied. The City must repay this amount from the General Fund to the Successor Agency for remittance to the County Auditor Controller and redistribution to the taxing entities. The City may eventually be able to recover the outstanding balance of this loan (now approximately $8.4 million, including the $2.2 million in denied payments) but the DOF must approve the future repayment schedule and, if approved, repayment will not begin until FY 2017.

*Property Transfer Tax* – this revenue category demonstrates improvement over third quarter projections of $596,000 (14.9%) and is a reflection of increased sales activity in the Hayward market. Staff is currently reviewing the details of the various real estate transactions (commercial and residential) to better determine the recurring or one-time nature of this improved revenue. Real Property Transfer Tax is a very volatile revenue source and is directly subject to market fluctuations. The high-point of this revenue was in FY 2006, when the City received $10 million in transfer tax revenues.

*Transient Occupancy Tax* – TOT improved over third quarter projections by $379,000 (29.2%) and is a direct reflection of increased hotel activity. Since the City is not seeing any significant improvements to its hotel market or the expansion of hotel beds, staff does not see this revenue stream continuing to grow at this rate.

*Charges for Services* – this revenue category includes a variety of police and fire fees, permits, and licenses; as well as building fees and permits. The overall reduction of $431,000 (-5.31%) is largely driven by several factors, including decreases in developer review fees, hazardous materials permits, fire prevention permits, and a decrease in supplemental improvement tax revenues. Staff will provide City Council with a more detailed analysis of this revenue category as the year-end audit concludes. It should be noted that while this overall revenue category shows a decline, building permits and some related activities are beginning to show improvement with year-end performance exceeding projections.

*Intergovernmental & Other Revenues* –As part of the implementation of the City's new financial system, some revenues were re-classified and basically switched between these two categories.

As part of the third quarter update, the Other Revenue category was updated to eliminate the annual transfer to the General Fund from the Workers' Compensation Fund. This transfer was essentially established to "reimburse" departments for the loss of employees that are off work due to a Workers' Compensation claim and is above and beyond the funding already provided in department budgets for these expenses. The Workers' Compensation Fund will realize a budgetary savings by not transferring these funds, which will be put towards the current Workers' Compensation unfunded liability of approximately $7.7 million.

**Preliminary Year-end FY 2013 Expenditure Performance (refer to Table 1)**

<u>Overall General Fund expenditures improved over third quarter projections with savings of approximately $1 million or 0.8%.</u>

*Net Staffing Expense* – this expenditure category is over expended by $297,000 (.3%). This is a small net variance that is caused by a variety of factors across all department budgets, including a failure to fully meet the target salary savings goal, an increase in public safety overtime, savings in budgeted medical and retiree medical benefits, and an increase in interdepartmental charges to non-General Fund projects.

*Non-personnel Expenses* – this expenditure category realized savings of $1.3 million (-4.9%). This is largely a one-time savings – with costs being deferred to FY 2014. Two issues are driving this one-time savings.

- In implementing the City's new financial system, substantial expenditure encumbrances were released on purchase orders where goods and services had not yet been purchased. Many of these expenditures will be re-encumbered in FY 2014 as part of the mid-year budget review to account for future purchases.
- In addition, the FY 2013 mid-year adjustments included appropriations for several Police Department grants totaling over $500,000 (e.g., Cal-Grip Grant, Office of Traffic Safety Avoid DUI Campaign, Byrne Memorial grant) that were not expended in FY 2013 and will be rolled into FY 2014.

**Increasing and Deferred Expenditures**
The City continues to face rising operating costs, largely related to employee benefit costs. In addition, in order to achieve a balanced budget these past few years – even with the use of the General Fund Reserve – a number of essential expenses have been excluded from budget consideration (e.g., increased staffing in some essential program areas, funding for benefit liabilities, and funding for infrastructure improvements). The City is now at a critical juncture where these

expenses can no longer be deferred and must be considered as part of the overall fiscal picture. Inclusion of these costs will negatively impact the bottom line in future years, requiring the continued need for recurring budget balancing measures.

**NEXT STEPS**

Staff will present a comprehensive FY 2013 Year-End review to City Council at the end of calendar year 2013.

*Prepared and Recommended by:* Tracy Vesely, Director of Finance

Approved by:

Fran David, City Manager

## Table 1 – Preliminary FY 2013 General Fund Budget Summary

| | | A | B | C | D | E | F |
|---|---|---|---|---|---|---|---|
| | | Adopted (6/26/12) | Q2 (3/5/13) | Q3 (5/22/13) | Year-End (10/21/13) | Change $ (D-C) | Change % (D-C) |
| | **Revenue** | | | | | | |
| 1 | Property Tax (1) | 35,768 | 35,768 | 37,200 | 39,181 | 1,981 | 5.3% |
| 2 | Sales Tax | 26,590 | 27,940 | 28,600 | 28,534 | (66) | -0.2% |
| 3 | UUT | 15,096 | 15,096 | 15,096 | 14,940 | (156) | -1.0% |
| 4 | Franchise Fees | 9,686 | 9,686 | 9,686 | 9,657 | (29) | -0.3% |
| 5 | Property Transfer Tax | 3,525 | 4,000 | 4,000 | 4,596 | 596 | 14.9% |
| 6 | Business License Tax | 2,448 | 2,448 | 2,448 | 2,493 | 45 | 1.8% |
| 7 | Transient Occupancy Tax | 1,418 | 1,418 | 1,300 | 1,679 | 379 | 29.2% |
| 8 | Other Taxes - Emergency Facilities Tax | 1,754 | 1,754 | 1,754 | 1,869 | 115 | 6.6% |
| 9 | Charges for Services | 8,190 | 8,140 | 8,140 | 7,709 | (431) | -5.3% |
| 10 | Other Revenue | 3,850 | 3,850 | 2,589 | 201 | (2,388) | -92.2% |
| 11 | Intergovernmental | 2,713 | 3,302 | 3,302 | 5,363 | 2,061 | 62.4% |
| 12 | Fines and Forfeitures | 2,570 | 2,770 | 2,770 | 2,913 | 143 | 5.2% |
| 13 | Interest and Rents | 453 | 453 | 368 | 384 | 16 | 4.3% |
| 14 | **Total Revenue** | **114,061** | **116,625** | **117,253** | **119,519** | **2,266** | **1.9%** |
| 15 | Transfers in | 3,867 | 3,836 | 3,836 | 4,064 | 228 | 6.0% |
| 16 | **Total Revenue/Resources** | **117,928** | **120,461** | **121,089** | **123,583** | **2,494** | **2.1%** |
| | **Expenditures** | | | | | | |
| 17 | Salary | 64,680 | 63,215 | 63,215 | 63,013 | (202) | -0.3% |
| 18 | Overtime | 5,384 | 6,513 | 6,513 | 6,879 | 366 | 5.6% |
| 19 | Target Salary/Vacancy Savings | (1,500) | (1,270) | (1,270) | 0 | 1,270 | -100.0% |
| 20 | Fringe Benefits (Medical, Dental, etc) | 10,934 | 10,934 | 10,489 | 10,083 | (406) | -3.9% |
| 21 | Retiree Medical | 2,321 | 2,586 | 2,586 | 2,321 | (265) | -10.2% |
| 22 | Worker's Compensation | 4,939 | 4,939 | 5,035 | 5,192 | 157 | 3.1% |
| 23 | Other Benefits (Medicare,Unemployment) | 1,276 | 1,275 | 1,330 | 1,030 | (300) | -22.6% |
| 24 | PERS | 15,317 | 15,193 | 15,193 | 15,147 | (46) | -0.3% |
| 25 | ***Staffing Subtotal*** | **103,351** | **103,385** | **103,091** | **103,665** | **574** | **0.6%** |
| 26 | Interdepartmental (ID) Charges | (5,113) | (5,300) | (5,300) | (5,577) | (277) | 5.2% |
| 27 | ***Net Staffing Expense*** | **98,238** | **98,085** | **97,791** | **98,088** | **297** | **0.3%** |
| 28 | Maintenance & Utilities | 1,018 | 1,018 | 1,018 | 908 | (110) | -10.8% |
| 29 | Supplies & Services | 6,374 | 6,374 | 6,374 | 6,218 | (156) | -2.4% |
| 30 | Internal Service Fees | 9,294 | 9,294 | 9,294 | 9,300 | 6 | 0.1% |
| 31 | Minor Capital | 0 | 0 | 20 | 37 | 17 | 85.0% |
| 32 | Transfers Out (includes CIP) | 8,600 | 8,600 | 8,800 | 8,806 | 6 | 0.1% |
| 33 | FY 2013 Mid-Year Adjustments | | 1,072 | 1,072 | 0 | (1,072) | -100.0% |
| 34 | ***Non-Personnel Expenses Subtotal*** (2) | **25,286** | **26,358** | **26,578** | **25,269** | **(1,309)** | **-4.9%** |
| 34 | **Total Expenditures** | **123,524** | **124,443** | **124,369** | **123,357** | **(1,012)** | **-0.8%** |
| | **Total Surplus/(Shortfall)** | **(5,596)** | **(3,982)** | **(3,280)** | **226** | **3,506** | |

*(1) Property Tax revenue as displayed in Column D includes $1.9M of one-time revenues ($880K from Alameda County and $1.1M from RDA dissolution)*

*(2) Expenditures as reflected in Colum D include the deferral of about $1M in expenditures to FY 2014 and excludes the Annual Required Contribution to the City's Retiree Medical program (gap of $3.9M)*